Lingering Producer Inflation Adds Market Jitters

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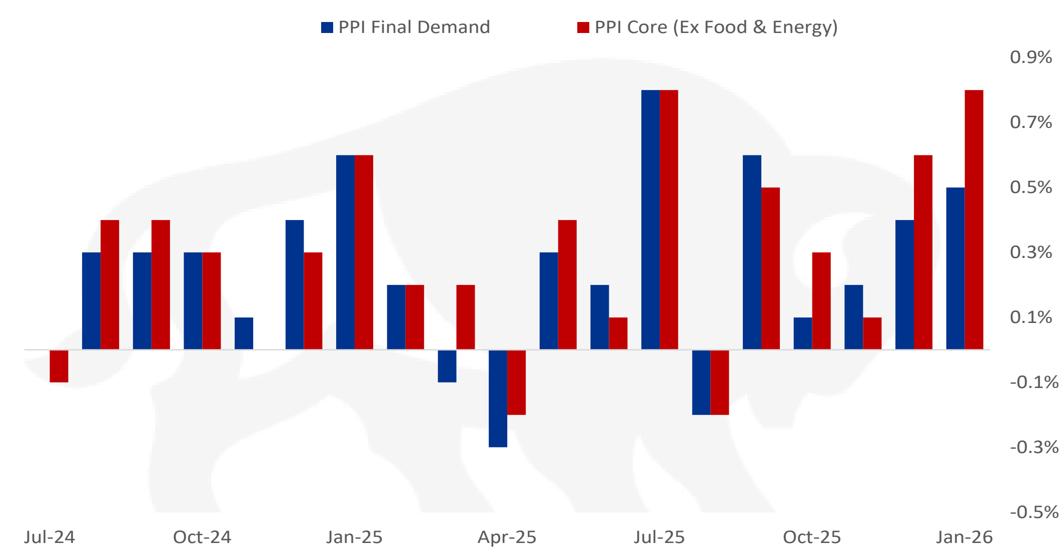
The widely accepted narrative that inflation is under control was disrupted this morning as wholesale prices prove stickier than expected. Headline PPI rose +0.5% in January, while core PPI jumped +0.8% following a revised +0.6% gain in December, marking the largest back-to-back increase in core PPI in nearly four years. On an annual basis, core PPI rose from +3.3% to +3.6%, the highest since last March.

The breakdown was telling as final demand services jumped +0.8%, the biggest gain since last July, while final demand goods declined -0.3%, the sharpest drop in almost a year. Margin costs increased the most since 2009, presumably as companies passed along a greater percentage of import taxes. Underlying PPI, excluding food, energy, and trade services, rose +0.3% for the month, and +3.4% for the year, *up sharply from a cycle low of +2.6% last June.*

Producer prices are generally considered less important than consumer prices, but a number of PPI components flow into the Personal Consumption Expenditures (PCE) index, the Fed's preferred inflation measure. Although investors and the markets have a tendency to focus on the more familiar CPI measure, the Fed favorite has been quite a bit warmer in recent months. In a release last week from the Bureau of Economic Analysis (BEA), headline PCE rose +0.4% in December and +2.9% year over year, while the core rate climbed +0.4% and +3.0%, *both above expectations*. The main difference between core CPI (+2.5% yoy in January) and core PCE is in the category allocations. The shelter cost weighting in the CPI index is twice as high as in the PCE index, while PCE assigns a higher allocation to healthcare costs.

Producer Price Index (Month-over-Month Percent Change)



Source: Bureau of Labor Statistics

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A warmer inflation outlook would likely result in a more cautious Fed, keeping the FOMC on hold for longer. However, the inflation picture is muddled and ever-evolving. February CPI is scheduled for release on March 11, while January PCE is on tap for March 13. These two reports should better clarify the trend.

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Stocks are down in early trading, although the drop probably has little to do with PPI as there are several contributing factors. WTI crude topped $67 per barrel this morning, the highest price for oil since last June, while OpenAI's $110 billion funding announcement is adding to A.I. bubble concerns. Despite expectations of a longer Fed pause, bonds are rallying as investors seek the safe harbor of Treasuries, nudging yields lower for the second straight day.

Market Indications as of 11:17 A.M. Central Time

DOW	Down -670 to 48,829 (HIGH: 50,188)
NASDAQ	Down -237 to 22,642 (HIGH: 23,958)
S&P 500	Down -38 42 to 6,870 (HIGH: 6,979)
1-Yr T-bill	current yield 3.49%; opening yield 3.49%
2-Yr T-note	current yield 3.40%; opening yield 3.42%
3-Yr T-note	current yield 3.40%; opening yield 3.43%
5-Yr T-note	current yield 3.53%; opening yield 3.56%
10-Yr T-note	current yield 3.97%; opening yield 4.00%
30-Yr T-bond	current yield 4.64%; opening yield 4.65%